DOW THEORY LETTERS INC.

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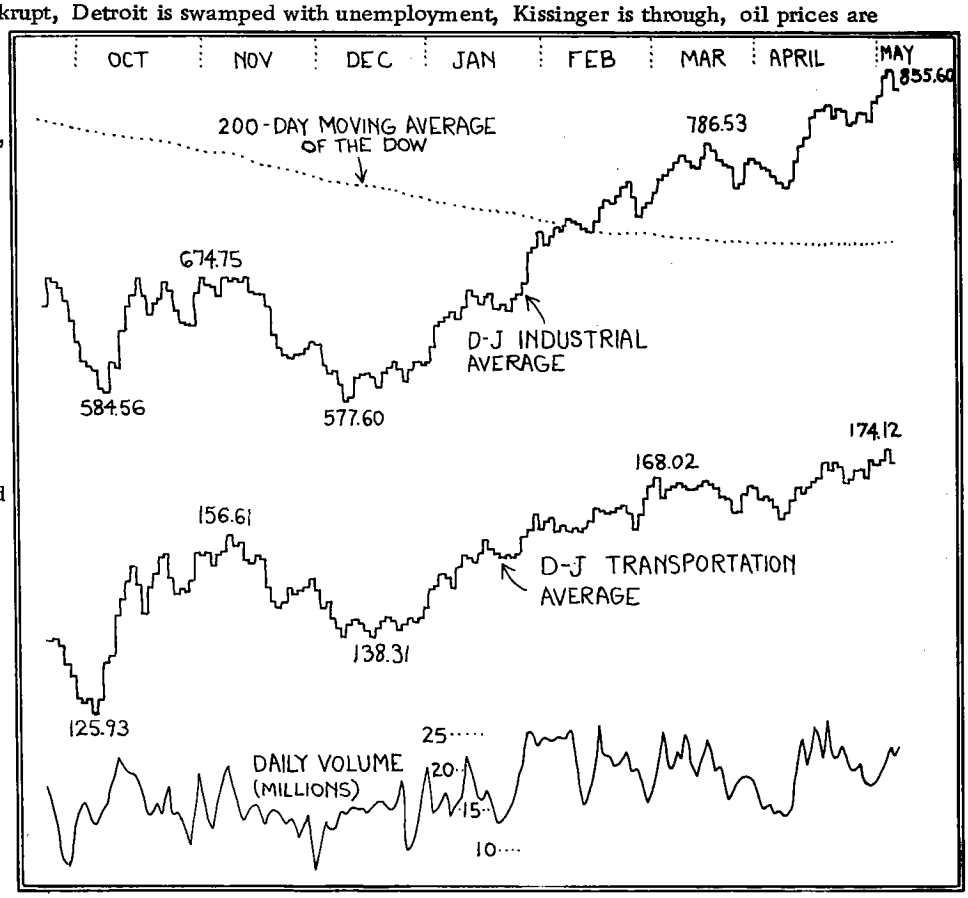
THE PICTURE: The world is moving fast. What used to take years to occur, now seems to take six months to a year. The balance of power is shifting. The Arabs have huge sums of money, West Germany has fat reserves, China and Russia are now great powers. The US, the undisputed major power following World War II, has now become an enigma to the world. But one thing is clear. The US is no longer the sole power. It is just one of the powers.

I felt that Vietnam was the event that may have turned the tide on US world supremacy. If a billion one-dollar bills are piled up, they will reach 167 miles into the sky. The Vietnam war, besides costing 50,000 American lives and perhaps a third of a million casualties, cost 150 billion dollars. And the costs are not over yet, not by a long shot (why do you think the Viet Cong didn't destroy Saigon? Because they want to keep the US "happy" and in a paying mood). I believe the Vietnam war will go down in history as America's single worst exercise in arrogance, stupidity and waste. There is no way that the nation can recover from the pain and debts piled up by Vietnam.

Tie the Vietnam debts together with other unbelievable US debts based on welfare and military spending, and you have a nation that survives, exists, continues to function on massive bank deposit turnover and an ever-lasting roll-over of its debts. The situation can be likened to two businessmen. One is well financed, careful, ready to move only when the situation looks right. When he moves, he moves out of strength. The other is under-financed, must argue and plead with his bank for every new arrangement. He is always on the go, and, in fact, he must be on the go simply to survive. If he slows down for a month, if he stops running for a week, his debts eat him alive. He's in a constant state of semi-hysteria, buffeted this way and that by every hustler and every rumor that comes his way.

I'm sorry to say it, but the US is beginning to resemble the second businessman rather than the first. On every side we hear the warnings: The Social Security program is about to cave in, the US has to borrow another $60 billion, the money supply must be ballooned, New York City is bankrupt, Detroit is swamped with unemployment, Kissinger is through, oil prices are going up, interest rates will rise if the nation ever starts doing business again, the crime rate is sky-rocketing, Americans are dying from too much cholesterol, too much tension, high blood pressure — and on and on.



Is this just a crazy "survival syndrome" that will come and go like the great Sputnik panic or the McCarthy fears or the Cold War terror? Or is the nation really moving towards zero hour, the hour when men will lock themselves in their houses with a Colt 45, a bag of gold (under the floorboards, of course), a larder full of dried rice and lentils, and a book on Korean Karate.

I have given the whole problem a great deal of thought, and I think you can go three ways. (1) You can take the concept of the "coming great collapse" seriously. If so, then I recommend (and I'm not kidding) that you send for my friend Jim McKeever's Multinational Investment & Survival Letter (726 Richards St., Vancouver B.C. Canada) or the Inflation and Survival Letter (410 First St., S.E., Wash. DC 20003).

(2) You can take some precautions; you can follow the middle course; keep say 15% of your assets in gold (Krugerrands preferred), place say 50% of your money in US Treasury notes yielding around 8%, and use the rest for market operations as outlined in this report.

(3) You can conclude that "The whole survival thing is just part of a national hysteria, and it will pass into history along with dozens of other examples of mass fears and neuroses." In that case, you may want to simply ride with the trend, stay invested in the bull market and worry about it later when a bear market actually does arrive. "After all, " you can say, "the nation has been surviving with debt, borrowing, inflation and political idiocy ever since World War II. Why jump the gun on the end of the world?" Why not just wait until the signs become unmistakably clear? Besides, when it goes, it will all go, the bank accounts (along with the dollar and the banks), the gold (they'll confiscate it), the stocks, the houses, the little survival gardens, the passports, the tax havens, the whole bit. So why tear your hair out each and every day? What will happen, will happen. The Lord giveth and the Lord taketh away.

What's the solution? My answer is that the Lord also helps those who help themselves. We are supposed to take responsibility for our own lives, and if we don't — then who in the devil is going to care for us? Therefore, I choose the middle way, but I must say that I read Harry Schultz, Jim Dines, Jim McKeever, Bill Schaefer and other pessimists with great interest. They believe we're all riding a merry-go-round that's accelerating, and that in due time the air is going to be filled with wooden horses, flying bodies, gold rings and sputtering organ music. Meanwhile, it's a great ride.

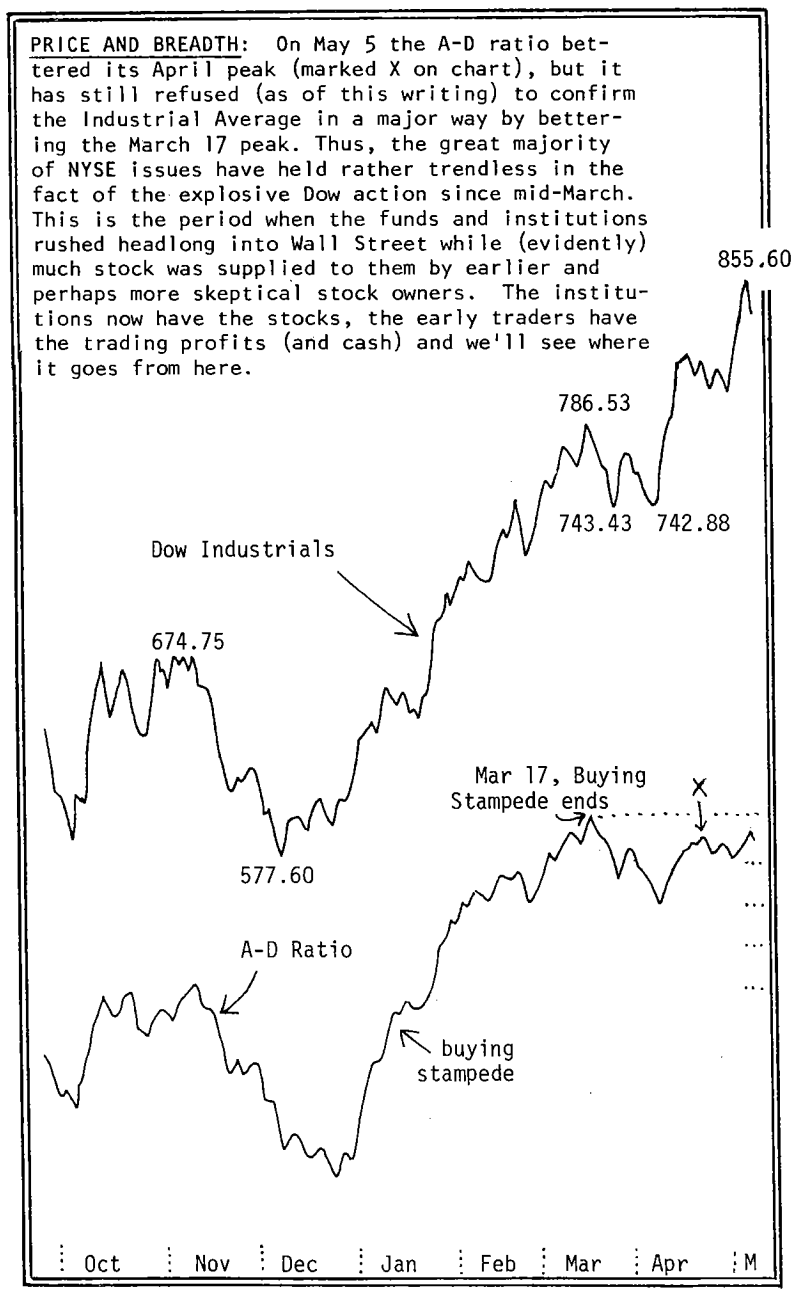
THE MARKET: I talk about a lot of subjects in these reports, everything from gold to interest rates to life in California to the stock market. When it comes to the stock market, I feel I have two basic jobs: The first is to tell people which way I think the market is going to go, and the second is to provide my readers with alternatives. In other words, given the market is going up or down, what are you going to do about it?

I often tell subscribers that the market always does "What it has to — to drive the greatest number of investors out of their minds." The years 1973 to 1975 provided perfect case studies for this adage. In the fact of booming business, the market collapsed all during 1973 and 1974. By the end of 1974, even the perpetual bulls were ready to throw in the sponge. Rally after rally had failed. It seemed that no force, no news, no Presidential promises, nothing could turn Wall Street around.

Then amid a totally demoralized Wall Street, the bottom came. The turn began in October, 1974 and it became more convincing in December. A violent and powerful primary bull signal occurred on January 27, and all the while a "buying stampede" was going on. The A-D ratio recorded an important peak on March 17, and following that date the character of the market changed. It became more furious but considerably less broad.

Between December and mid-March almost every stock on the Board moved up with large numbers of depressed issues doubling and even tripling in price. Following the A-D peak, the action began to concentrate in the Dow-type stocks. The institutions, caught with far less common shares than they wanted (now that they were convinced that it was a bull market), started moving up their common stock holdings towards the 75% level (up from 50% and 60% in many cases). The great institutional rush was on.

All of which brings us to the present, and to the question of the hour, "What in the devil is going on? What's happening?" We know we've been in a fantastic "power move," we know that it has been booming along on tremendous momentum. We also know that a number of technical indicators have been out-of-gear or lagging (but nevertheless moving up in direc-


PRICE AND BREADTH: On May 5 the A-D ratio bettered its April peak (marked X on chart), but it has still refused (as of this writing) to confirm the Industrial Average in a major way by bettering the March 17 peak. Thus, the great majority of NYSE issues have held rather trendless in the fact of the explosive Dow action since mid-March. This is the period when the funds and institutions rushed headlong into Wall Street while (evidently) much stock was supplied to them by earlier and perhaps more skeptical stock owners. The institutions now have the stocks, the early traders have the trading profits (and cash) and we'll see where it goes from here.
855.60
786.53
743.43
742.88
Dow Industrials
674.75
577.60
Mar 17, Buying Stampede ends
A-D Ratio
buying stampede
Oct
Nov
Dec
Jan
Feb
Mar
Apr
M

tion). We know that the advance is becoming more selective, and that you really have to pick the right stock at this point. We also know that since December, 1974 (Dow 577.60) the Dow has been rising at a rate of just under 60 points per month, a rate never before seen, and one that is taking us wherever we are going awfully fast. For instance, a 60-point per month rate would put the Dow at 980 by the end of August, at 1100 by the end of October.

All during 1973 and 1974 the nation prospered, business boomed, and Wall Street was in a depression. Ironically, the shoe is on the other foot now. I noted in the last Letter that in the face of a business depression, Wall Street is now "the only game in town."

We have been witnessing a remarkable technical situation following the most dramatic bull signal in stock market history. It's a situation in which the market has been literally exploding, following history's worst breadth (A-D) collapse. We have seen a record 26 million shorts trapped, pressed against the wall. We have seen the Dow (last week) moving well above the critical 50% level of the 1973-74 decline. Odd-lotters have been selling almost two shares for every one purchased. It's a bull movement which, like so many before it, has become a law unto itself.

This is the question that I'm asked a dozen times a day: "Is the market telling us that business is going to turn up soon?" My answer is this: In the course of any given week, I talk to a good many market analysts, businessmen, economists and investors. Many of them are leaders in their fields. At this point these men tell me that they don't see any actual signs of a turn in the economy. The consensus is that the turn is coming. I ponder what I hear, I try to put it into a meaningful context. It boils down to the fact that the hopes are there, the optimism is beginning to grow a bit (each day some Governmental leader announces that "we're scraping the bottom"), but the statistics show very little worth cheering about — so far. Nevertheless, it doesn't pay to be too cute or cynical during a primary bull market. A healthy skepticism, however, is a valuable asset for anyone who has anything to do with the stock market.

All in all, this is one of the most fascinating situations I've seen in all the years in which I've been writing these reports. I remember the 1962 market collapse, a smash that was never followed by a downturn in business (the 1962 market went down on fear alone, but the economy held like a rock). Will today's market boom turn out to be the reverse of 1962? Since I always tend to distrust the consensus, I cannot help asking myself that question. Is this the market move that is fated (like 1962) to be purely psychological — fated to bring no real upturn to business? Obviously, I don't have the answer any more than Treasury Secretary Simon has the answer or Alan Greenspan has the answer. But it does strike me as rather comical that all those experts who never dreamed of a severe recession arriving in 1975 are the same experts who are now promising us a business boom late this year or next.

Actually (and you might say, ironically), I feel that one reason the market is going up is because a business upturn is not going to come easily. Thus, a stagnant economic picture is helping the bond market (the bond market would probably cave in if the current colossal Government debt requirements were piled on top of a pressing need for massive business loans). The fact is that the bond market is now acting considerably better than most experts thought it would. The reason is because business is not flooding the debt markets (since in many cases corporations are actually cutting back on expansion plans).

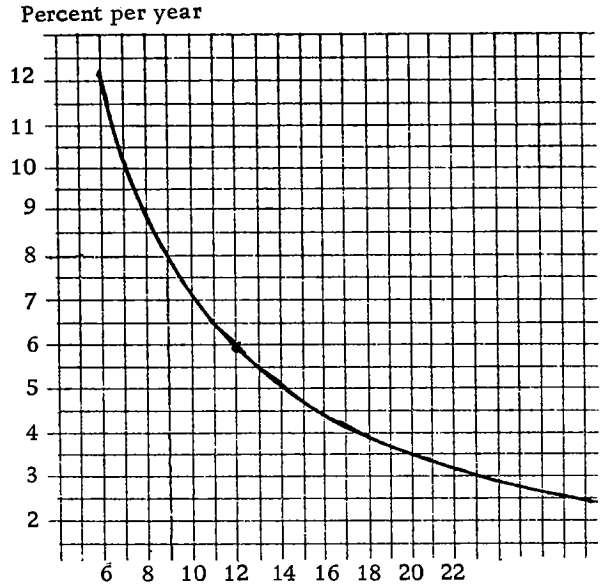
It is also ironic to note that the market is probably protecting itself against a strange series of events. Every month that goes by without a business upturn means more pressure on Congress for new spending, new defense programs, new make-work projects. And the sophisticated stock market is saying that the upturn will ultimately arrive — but meanwhile, every economic notch down is a spur towards even greater deficits to be voted in by a desperate vote-oriented Congress. Last week, for instance, Fed Chairman Burns announced that he wants the nation's money supply to expand at a 5% to 7% rate in 1975. Meanwhile, Congress pushes for a $70 billion deficit while President Ford warns that this is $10 billion more than the country can tolerate. On April 7 Congress was told that the Social Security System would run at a deficit for 1975, and the contributions would have to be raised. Ten years ago this would have set off a national furor. Here in 1975, it hardly made the front page of the morning newspaper (which is the best comment I can make on the national financial situation).

Whatever the outcome, one thing is clear. As the Dow climbs, as stock yields grow smaller, the spread between the Dow yield and the yield on Barron's Highest-Grade Bonds is moving over 4% in favor of bonds. The spread between the broad S & P 425 Industrials Average yield (3.9%) and S & P Aaa-rated bond yields (8.7%) is even greater — it's 4.78% in favor of bonds! And that means that the risk-reward for owning stocks is growing more tenuous with each passing week.

"Russell," you ask, "What are you trying to do, fight the bull trend? You're the guy who is always telling us that the strongest force in the market is the primary trend. You shouted 'bull market' back in December, and now you're the first bull to shout 'be careful.' What are you thinking about, Russell? Why don't you sit back and enjoy the ride?"

I write about Dow's Theory, and I write about investing (which is what Dow's Theory is all about). If any reader wants a tout sheet, if he insists on a perpetual list of "10 Stocks to Buy Now!" then he's reading the wrong service. I'll continue writing about investing as long as I put out this Letter, yet, as you know, I don't like giving advice. You make the choices, you take responsibility for your actions. I'll try to present my ideas about what's happening, the risk-rewards, the alternatives. And here is one thing that has been on my mind.

I have noted over the years that the average investor knows almost nothing about the fantastic power of compounded rates of interest. Yet in today's extraordinary era of high interest rates, compounded interest is one of the investors' most potent weapons. I have included a chart showing the time it requires money to double at various rates of compound interest. Where the interest rate meets the time period (on the curved dark line) is the time period required (for instance, at 6% money doubles in 12 years). Frame this chart and put it on your wall. It shows you what money is worth in a most realistic sense.



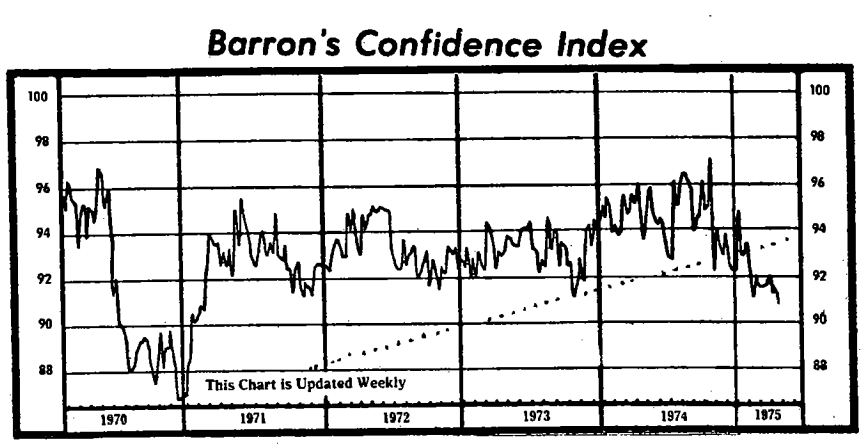
Years required for money to double at compounded annual rates of interest

People ask me what to do with their stock market profits (or their capital when they take it out of the market). Well, today you can buy US Treasury Notes yielding around 8%. At 8% (see chart) money doubles at a compounded rate in nine years. Many institutional managers used to say that they would be happy to make 8%, year after year on their portfolios (few can do it). But at today's Government-guaranteed rates, you can make 8% or double your money in nine years (not considering taxes). That, readers, is one hell of an alternative to stocks, gold, art or any other investment — and the investment world is beginning to wake up to it.

I don't think these abnormally high interest rates are going to last too much longer. Why do I say that? Because you can't do business (certainly real estate operators can't continue to sell houses) at these kinds of rates. Either the interest rate structure is going to come down (in which case bonds will go up in price) or the world economy is coming down (in which case US Government debt would be one of the safest instruments to own).

As a point of interest, you might study the daily Treasury bond quotes in the Wall Street Journal. This will provide you with prices and the yields to maturity. Then with the chart of compounded interest rates above, you will have a working knowledge of a superb alternative to equities — almost risk-free high-yielding medium-term (5-10 years) US debt in the form of Treasury notes.

I am including the M/G Financial Weekly's chart of the Barron's Confidence Index going back to 1970. This index is the ratio of the yields on Barron's High-Grade Bonds and the yields on the D-J 40-Bond Average. For years this index has been moving generally sideways, saying nothing. Now I think it is saying something. In dropping to a five-year low last week (90.6) it is saying that there is a most definite move by sophisticated investors to high-quality bonds. Which is another way of saying that confidence in general corporate debt is declining, and that investors are moving to the safety of the highest rated bonds.



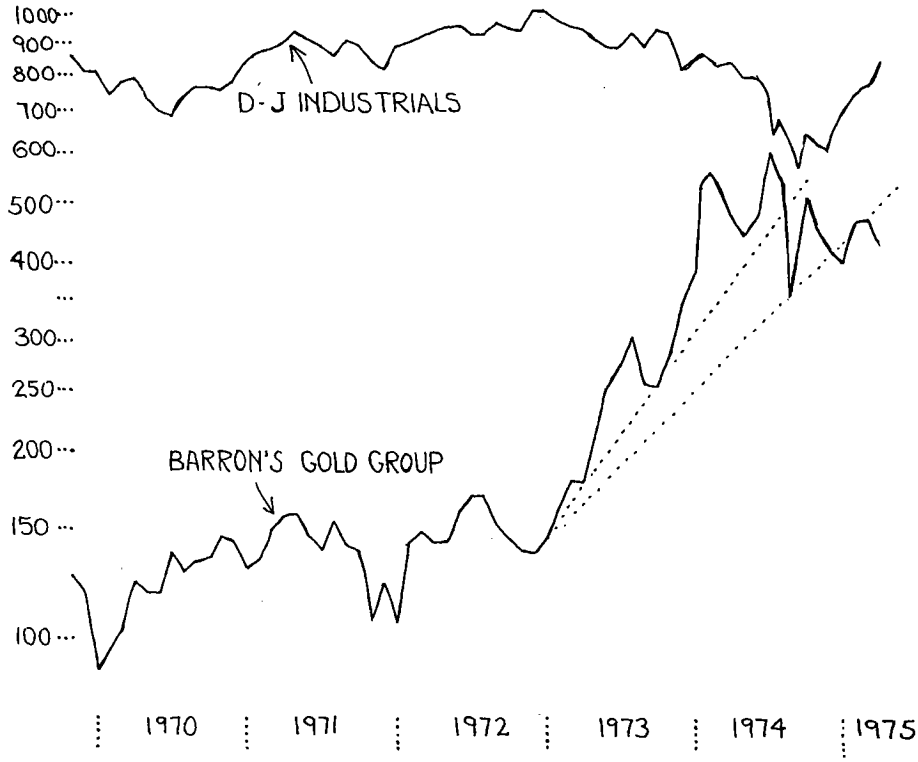
This index is a ratio of gilt-edge bond yields to speculative bond yields. Used since 1932, Barron's Confidence Index is based on the theory that informed, "smart money" interests act far ahead of the general public. Their confidence, or lack of confidence, is expressed by the manner in which they seek safety in higher grade bonds during unfavorable market periods. A flow of funds into more speculative, lower grade bonds would indicate a bullish attitude.

This is the same split that has been showing in the stock market, the split that saw the quality-type Dow stocks rally strongly while the majority of other issues (as reflected in the A-D ratio) refused to confirm. I don't care for this kind of action, it is not a particularly healthy picture, it may straighten out, but so far it has not.

My favorite piece of paper right now is the US Treasury 7-3/4 note of 1981. Here is a safe place to sock in your spare cash, your profits, savings, your assets. The note pays almost 8% at current prices, is relatively risk-free, is highly marketable, and comes to maturity in six years. Two other T-notes that I like are the 6-7/8 of 1980 that yields near 7.75% and the 7 of 1979 that yields over 7.5%.

GOLD: Ah, the great gold mystery; does anyone know what gold is doing? The first quarter reports are out on the mines now, and in general, they don't make good reading. Average price of gold down, costs up, and in S. Africa a problem of insufficient labor. Wage boosts are the order of the day in S. Africa. With the problem of getting more blacks to work in the mines, one of the incentives is obviously higher wages, which means there will probably be another wage rise in June.

I include my monthly chart of the Dow and Barron's Gold Average, and it tells the whole story. Barron's Gold Average is weighted 19.9 x for ASA, 3 x for Dome, 4 x for Homestake and 1 x for Lakeshore, so you can see it's practically a S. African index. By mid-1974 the Gold Average and the Dow were selling at literally the same price. That was the period in which the golds were hitting their bull market peaks, while the Dow was in the throes of its bear market crash.



By September gold was collapsing along with the Dow. Since then, there has been a parting of the ways. Gold has broken its second trendline from the 1972 low, and the gold stocks are now attempting to stabilize in the low 400's on Barron's Gold Average. Volume is drying up in the golds and interest is waning. Even sharp drops in the Dow fail to bring in the usual counter-cyclical interest in the gold shares.

We could be seeing slow attrition in the shares as the price of gold holds listlessly in the 160-70 area and as the costs for the mines go up. I feel it would take $250 to $300 gold to push the gold shares into another real bull market or to take most of the shares up to their old highs. But I doubt that we're going to see that kind of price on gold anytime soon. I doubt it because the forces of delfation are still persistent in the economy, commodities are sliding, consumer spending is stagnant, and people are resisting higher prices by not buying. The overall long-term picture may be inflation, but for now the forces of deflation have served to "cool it" in the economy. The gold shares foresaw all that last year, and they reacted first by going down, then by going "dead."

Tom Holt says buy the gold shares and skip the bullion and the coins. His reason is that all true investments provide a return and bullion (since it pays no dividends) is simply a speculation. Harry Browne says hold the bullion or the coins because the stocks are too risky. But if you must own stocks, he says, buy the most speculative and the most leveraged gold shares. If the price of gold heads up, these are the ones you'll make the real percentage gains in (and since they tend to be low-priced, you won't tie up too much capital in them).

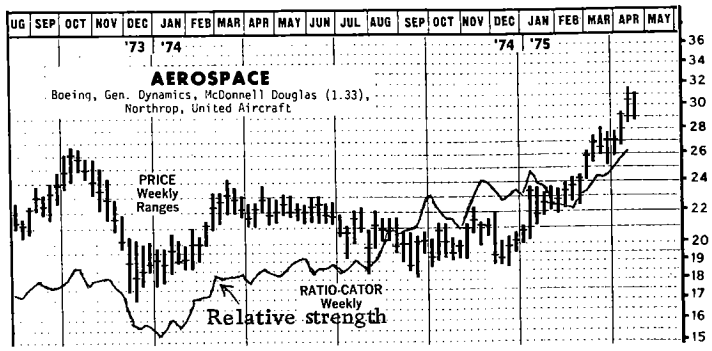
What do I think? I'd rather wait and see, but if I had to move I'd hold 15% in Krugerrands and be watching Homestake (whose uranium interests may some day be as interesting as its gold interests). But I'm more interested in timing, and I prefer to buy when a group has rising relative strength and momentum (neither of which the golds have at this time).

CURRENT MARKET: On May 6 the market suddenly sold off with US Steel leading the decline. With the Dow down 20 points at the close but with only 7 new lows for the day and a plurality of only one more of the most-actives down than up, I found the decline unconvincing. I count the decline as just one more bench mark on a market that has become speculative and rather ragged. Interestingly, since March it has been the Utilities, the Bonds and the A-D ratio which have given the toppy look to this market. With the initial Government financing moving out of the way, it could be that Utilities and Bonds will be in position to rally. On top of this, the moment of truth is coming up for the A-D ratio.

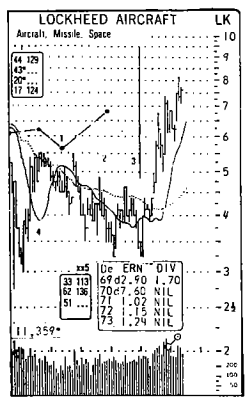
The reason I focus attention on the A-D is that this index (see page 2 chart) is now within half a point of its March 17 peak. Any rally that is capable of taking the Dow over its May 5, 1975 high "should" be able to take the A-D ratio over its March 17 peak. A new high on both the Dow and the A-D ratio, following all the recent out-of-gear action, would be both remarkable and highly bullish. I say remarkable because history shows few examples of breadth-price divergences that are ultimately resolved on the upside (without a major correction). Thus, in the period directly ahead we can watch for a new Dow high above 855.60, a new

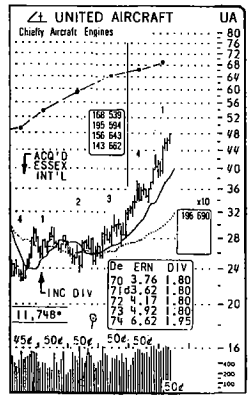
A-D high above the March 17 peak, and of course a confirmatory new Transport high above the May 5 peak of 174.12.

STOCKS: I just finished reading Tom Holt's latest Holt Investment Advisory. Holt is one smart cookie, and he particularly interests me because at this time he differs with almost everybody on the path of the economy. Holt doesn't think we're going to have a real business pick-up; no, he thinks the US is heading into depression. I don't know if Holt is right or not, but my intuition tells me that the answer could be mid-way between Holt and the optimists. In other words, an economy that rises a bit (providing hopes), then sags, then goes nowhere.



If that happens (with an election coming next year) the Administration is going to rush to spend even more. The one place where they can spend in a hurry and where the money goes right into the economy is Aerospace. Look at this group and relative strength chart of Aerospace. It seems to be telling a story (chart courtesy of Securities Research, 208 Newbury St., Boston MA 02116). I recommended United Aircraft, which has been renamed United Technologies. I recommended the stock in the low 30's (Letter 620), but the stock is one of the leading aerospace equities, and it is still an interesting number, even in the high 40's. The speculative stock in the group that I think has possibilities is Lockheed. It is probably that LK has passed the worst of its crisis situations, and cash flow is now improving. LK is a candidate for a merger, and the chart seems to be saying that it's not going to be "bankruptcy-city" for LK.





ANNOUNCEMENT: A good many (I'd say most) of the leading services in this industry are written via a joint effort: the "name analyst" plus his staff. Rightly or wrongly, I don't do it that way. I write the whole report myself, every word of it. I've been doing it that way since I started in 1957, and if there's any change, I'll let my readers know about it.

Anyway, it's a lot of work, which is OK, because I love this business, and I wouldn't want to do anything else. However, this report is priced under most in the field, and I feel that it's worth at least as much as the average. In fact, Dow Theory Letters is half the price of a few other leading services, services that often quote my writing profusely. So without any further pussyfooting, I'll simply say that I want to raise the price (and I'm going to refrain from offering the usual inflation excuses). As of June 1, the new rates for these reports are going to be $125 for an annual subscription, and $75 for six months.

However, I want to give all my subscribers a fair chance of staying with the old price. Therefore, I'll accept extensions to your current subscription at the following rates: one year extension (from whatever date your present subscription ends) at $85. A two year extension on your current subscription for $160. A three year extension for $220. This extension offer will close on June 1.

NOTES: I have just finished reading "Super Yields" by my old friend, Sam Coslow (founder and former owner of Indicator Digest). This is a very good book and one well worth reading and studying. If you get just one new idea here (and I did) it will be worth the $10 it costs. The book is published by the Hirsch Org., 6 Deer Trail, Old Tappan NJ 07675. It's probably in your local bookstore, and in case you're curious, I make no commission or fee when I recommend a book.

While I'm at it, I should also add that I do not handle personal accounts, nor do I promise to answer personal mail. Neither do I offer personal consultations, but if you happen to catch me on the phone or anyplace else, my charge is zero. Since I charge nothing, I also reserve the right to refuse to talk about the stock market or investments (which is one of the ways I try to stay sane in this business).

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In the last Letter I mistakenly referred to John McFalls' "Value-Action Advisory" and Value-Trend. John, I'm sorry, and it is Value-Action. The address is 3838 48th Ave., NE, Seattle WA 98105. John offers the Voice of Gold free telephone rundown on gold and gold shares daily. To catch it you dial area code 206 KAF-FIRS. Don't ask me how John wheedled that telephone number out of the telephone company, it must be his gift of blarney.

LATE, LATE NOTES: Oops, charts above of United Tech. and Lockheed courtesy of Quote, PO Box 213, Wichita KS 67201. And a final note on the market: irony — just as the A-D gets within a half point of confirming by possibly going through the March 17 peak, it's the Dow that runs out of steam. As I've been saying, this is a very ragged market, and maybe it is finally getting winded.